

Letter of Findings Number: 04-20130325
Sales/Use Tax
For Tax Years 2009-2011

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ISSUE

I. Sales/Use Tax– Labels.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-5-2; IC § 6-8.1-10-1; [45 IAC 2.2-5-14](#); *Wendt LLP v. Indiana Dept. of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012).

Taxpayer protests the imposition of use tax on labels and label software. Taxpayer also protests the imposition of interest.

STATEMENT OF FACTS

Taxpayer is a manufacturer of "shelf-stable" meals. The Department conducted a sales and use tax audit for the years 2009, 2010, and 2011. As a result of that audit, the Department issued proposed assessments. Taxpayer filed a protest regarding a portion of the proposed assessment. Specifically, Taxpayer protested that it "disagree[s] with the assessment regarding the purchases" of labels and label software. An administrative hearing was conducted and this Letter of Findings results. Further facts will be supplied as required.

I. Sales/Use Tax– Labels.

DISCUSSION

At the outset, the Department notes that under IC § 6-8.1-5-1(c) "burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." The Indiana Tax Court has also stated, "It is well-settled that tax exemptions are to be strictly construed against the taxpayer, and the taxpayer bears the burden of proving entitlement to the exemption." *Wendt LLP v. Indiana Dept. of State Revenue* 977 N.E.2d 480, 483 (Ind. Tax Ct. 2012) (quoting *Grand Victoria Casino & Resort, LP v. Indiana Dep't of State Revenue*, 789 N.E.2d 1041, 1044 (Ind. Tax Ct. 2003)).

As noted above, Taxpayer is a manufacturer of "shelf-stable meals" which includes meals-ready-to-eat and unit group rations. The Audit Report states that the majority of Taxpayer's products are sold to the government "and other not-for-profit organizations for military and emergency rations." The Audit Report also notes the following:

As the audit progressed, the auditor became aware of the refund claims filed by [Taxpayer's representative] on behalf of the taxpayer, covering 2008 through 2010. The refund claims included both sales tax paid to vendors and use tax self-assessed by the taxpayer.

The Audit Report cites to IC § 6-8.1-5-2(g) regarding erroneously granted refunds. The Audit Report states that "since the refunds claimed by the taxpayer were issued on 6/3/2011 and on 11/29/2011, the Department may issue assessments through the corresponding dates in 2013."

IC § 6-8.1-5-2(g) states in relevant part:

If any part of a listed tax has been erroneously refunded by the department, the erroneous refund may be recovered through the assessment procedures established in this chapter. An assessment issued for an erroneous refund must be issued:

- (1) within two (2) years after making the refund; or
- (2) within five (5) years after making the refund if the refund was induced by fraud or misrepresentation. (Emphasis added).

Under the rubric of that IC § 6-8.1-5-2(g)(1), the Audit reduced the Taxpayer's previously claimed refund. Turning to Taxpayer's protest, Taxpayer states:

Please note we disagree with the assessment regarding the purchases from [Company T] by [Taxpayer]. These purchases are labels for individual MRE (Meals Ready-to-Eat) cases for tracking purposes by [the governmental entity] and the label software for printing them.

Taxpayer argues that the labels are "incorporated into the Tangible Personal Property that is resold" to the government and "are exempt under [45 IAC 2.2-5-14](#)." Taxpayer concludes its argument by asserting, "These labels are an integral part of the MRE's processed and shipped to ensure safety and delivery in accordance with the governmental contract."

[45 IAC 2.2-5-14](#) states:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property which is to be incorporated by the purchaser as a material or an integral part into tangible personal property produced for sale by such purchaser in the business of manufacturing, assembling, refining or processing.
- (b) The exemption provided by this regulation [\[45 IAC 2.2\]](#) applies only to tangible personal property to be

incorporated as a material or an integral part into tangible personal property produced for sale by a purchaser engaged in the business of manufacturing, assembling, refining or processing. This regulation [\[45 IAC 2.2\]](#) does not apply to persons engaged in producing tangible personal property for their own use.

(c) This regulation [\[45 IAC 2.2\]](#) does not exempt from tax tangible personal property to be used in production, such as supplies, parts, fuel, machinery, etc., refer to Regs. 6-2.5-5-5(010) and 6-2.5-5-5(020) (dealing with material consumed in direct production) for the application of those regulations to taxpayers engaged in the production of tangible personal property.

(d) The purchase of tangible personal property which is to be incorporated by the purchaser as a material or an integral part is exempt from tax. "Incorporated as a material or an integral part into tangible personal property for sale by such purchaser" means:

- (1) That the material must be physically incorporated into and become a component of the finished product;
- (2) The material must constitute a material or an integral part of the finished product; and
- (3) The tangible personal property must be produced for sale by the purchaser.

(e) Application of general rule.

- (1) Incorporation into the finished product. The material must be physically incorporated into and become a component part of the finished product.
- (2) Integral or material part. The material must constitute a material or integral part of the finished product.
- (3) The finished product must be produced for sale by the purchaser.

Taxpayer's contract with the government, per the Audit Report, "specifies that the taxpayer must apply RFID labels to each carton." The Audit Report states that the labels "contain electronically stored information which can be read from up to several meters away, using wireless non-contact radio-frequency electromagnetic fields to transfer data." This allows "all of the carton data for the entire shipment" to be "read automatically without the need for physical inventory of each carton in the shipment." The Audit Report explains:

The taxpayer produces the individual meals and packages them in an individual meal container (box). The taxpayer produces 24 menus of meals. They package the individual meals (boxes) in two separate cartons (A & B). Thus, menus 1-12 are in cartons identified as "A", and meals 13-24 are in cartons identified as "B." Having one of each carton provides the entire range of menu possibilities. The taxpayer's production line begins with food preparation, and continues through sealing the cartons (either A or B), and securing each carton with two mesh bands. The cartons are then removed from the production line.

The Audit Report further states in part:

Prior to shipment, cartons are transported to the "palletizer line." This is a post- production line, located in a separate area of the plant. At this line, the RFID labels are electronically encoded, physically printed with a barcode and label ID to match the encoding, and are applied to the outside of each carton.

The auditor concluded:

[T]he RFID labels do not qualify as being incorporated into the product under [45 IAC 2.2-5-14](#), because they are not physically incorporated into the finished product. They are added to the outside of the cartons after production has ended and bear no relation to the preparation or consumption of the food.

[45 IAC 2.2-5-14](#)(d) states in pertinent part:

"Incorporated as a material or an integral part into tangible personal property for sale by such purchaser" means:

- (1) That the material must be physically incorporated into and become a component of the finished product;
- (2) The material must constitute a material or an integral part of the finished product; and
- (3) The tangible personal property must be produced for sale by the purchaser.

In the case at hand, the RFID labels are not incorporated into the tangible personal property for sale (i.e., the MRE's are the finished product). The labels, per the Audit Report, are applied to the outside of the carton. From the photograph of the labels provided by Taxpayer, they are barcoded shipping/tracking labels. Taxpayer has not met its burden of proof regarding the RFID labels; Taxpayer's protest of the RFID labels and label software is denied. Also, interest cannot be waived, per IC § 6-8.1-10-1(e), thus Taxpayer's protest of the imposition of interest is denied.

FINDING

Taxpayer's protest is respectfully denied.

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